



# CONTROLLER'S MONTHLY REPORT

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## Nevada's Budget Challenges: A Public-interest Perspective on Revenues

The first Controller's Monthly Report addressed state spending. This one reviews state revenues. Nevada Revised Statutes 227.110(2), provides: "The State Controller may recommend such plans as he or she deems expedient for the support of the public credit, for promoting frugality and economy, and for the better management and more perfect understanding of the fiscal affairs of the State." Via recommendations based on facts, data and analysis, I seek to help Nevada's People, Legislature and Administration address issues in ways that best serve the long-term public interest. In sum, the issues here are:

- 1) Nevada state revenues include state taxes and program revenues (including federal and other grants and contracts, plus charges for services) that have amply served the public interest. Less than half of Nevada state revenues comes from taxes paid directly to the state. The rest comes mainly from charges for services, plus grants and contributions -- which include large amounts from the federal government that have grown faster than tax revenues but which have been offset by huge federal spending mandates. In the last decade, Nevada has added a modified business tax and a new motor vehicle services tax increment. Relative to our economy, tax revenues have grown for unemployment insurance, services provided largely to tourists (auto rentals and lodging since 2010) and mining. All other tax revenues, including sales and gaming taxes (the two largest ones), have decreased to various degrees relative to the incomes of Nevada families and businesses. *Both total tax revenues and charges for services have increased slightly relative to income since 2008; in the mid-2000s, they grew at a slightly slower rate than Nevada's economy. Total state revenues have increased at roughly the same rate as state spending, and both spending and taxes have grown significantly faster than Nevada's economy (which is measured by personal income).*
- 2) Every cent taken in taxes is an act of destruction of human and social wellbeing; so, public spending items should not be adopted unless they clearly provide benefits exceeding the damage done by taxes required to support them. Taxes are collected via government coercion. So, they diminish the lot of those paying them and thus are inherently destructive to their wellbeing and to the society of which they are a part. Of course, taxes are required to fund government activities, including public services and benefit payments to recipients of them, some of

whom also pay taxes. However, not all public spending is beneficial; moreover, even for the majority that is, one must always ask whether its net benefits to society exceed the social costs of taxes to pay for it. The essence of sound fiscal policy is to deploy only the least destructive tax methods and most beneficial spending measures, and to find the taxing/spending balance point that maximizes the net social benefits and public wellbeing.

- 3) All taxes are "unfair" because they can't be charged according to the social costs that people cause, nor the benefits they receive. Fairness being illusory, in taxation as in other public policy, we should seek to maximize economic growth and the human wellbeing that growth fosters. People often make claims about fairness in seeking to lower their taxes and shift burdens to others. However, because taxes cannot be levied to charge persons for the public benefits they get individually nor for the public costs they cause, there is no truly fair tax. Instead of indulging inherently subjective and self-serving fairness claims, sound tax policy should focus on the main thing that serves the broad public interest: maximizing economic growth (or growing the social pie as fast as possible). "Ability to pay" criteria, which have a superficial ring of fairness, are particularly destructive to the broad public interest in growth. And claims that taxing one person to subsidize another involves "compassion" are false.
- 4) The real tax fairness issue is that public spending's beneficiaries (public employees and contractors, plus those receiving public payments) have an unfair advantage over taxpayers and the public, an advantage that produces excessive taxing/spending levels via politics. Public choice analysis, which has yielded much Nobel Prize work in economics, teaches us this: In political processes, parties that have relatively few members with large average individual stakes in an issue will generally enjoy greater success than parties with more members who have small average individual interests in the issue. In taxes and public spending, the individual stakes of public employees, contractors and benefits recipients are, on average, much larger than the individual stakes of taxpayers. There are more taxpayers than recipients of public payments, but taxpayers' average individual stakes in tax and spending issues are typically much smaller. So, due to their large numbers, taxpayers' costs to organize and participate effec-



tively in the political processes deciding those issues are so much greater than those for recipients -- and the taxpayers' incentives to do so are so much smaller than those of beneficiaries of public spending -- that the latter will succeed in pushing tax and public spending levels higher than the growth-maximizing levels that serve voters, taxpayers and the broad public interest.

All these considerations reinforce the conclusions of Controller's Monthly Report #1 that to leave our children a better future, we must stop the growth relative to the economy and to Nevadans' incomes of public spending that drives taxes. We must especially avoid mistakes such as adopting versions of the business margins tax defeated 4-1 by voters last November. We must re-prioritize public spending for maximum social benefit, not continue some programs and spending just because they've been funded in the past. We must also restructure fiscal processes for real budget constraints and effective cost management; emphasize no- and low-cost reforms in K-12 education; and eliminate collective bargaining between unions and local governments and prevailing wage rules that inflate costs hugely and thus raise taxes.

## Further Detail on the Key Issues Summarized Above

**1) Revenue facts, trends and sufficiency:** Table 1 displays the sources of Nevada state revenues, showing first the three basic sources: total taxes (42% of the dollar figures in the table, or 4,353/10,378), charges for services (15%), and grants and contributions (39%), plus minor sources, "Other changes in net position" (3%). So, "general revenues" are 45% (4,705/10,378) of the total and "program revenues" are 55% in the most recent fiscal year (2014). These percentages have varied greatly over the last decade, a variation driven much by extreme increases in federal funding for unemployment compensation payments in the wake of the Great Recession, followed by similarly large declines in those receipts.

	Percent Total Change vs. Change in Personal Income		
	FY 2014 \$ Million	2008-2014	2004-2014
<b>Taxes, Charges, Grants/Contributions</b>			
Total Taxes	4,353	3	-2
Other Changes in Net Position	352	23	-23
Total General Revenues	4,705	4	-4
Charges for Services	1,604	5	-6
Grants & Contributions	4,069	54	39
Total Program Revenues	5,673	36	22
Total Program and General Revenues	10,378	19	9

Notes: Percent changes in Other Changes in Net Position are not very meaningful.

Overall, program revenues have increased significantly faster than general revenues, especially in the slow economic recovery since the recession. This increase has been due mainly to increases in revenues from grants and contributions (especially from the federal government), and their fastest growth has taken place since the recession. Total general revenues have grown quite slowly over the last decade, especially since the recession. Before the recession, they grew slower than Nevada's economy; since the recession, they've grown faster than the economy, although both grew only tepidly. The net ten-year result is that general revenues grew somewhat slower than the economy, with both growing weakly.

Table 2 shows the change in tax revenues by tax category. Nevada added the modified business tax in 2004, reaping low first-year revenues; a new motor vehicle basic government services tax increment in 2010; and the transient lodging tax in 2010. So, there are no meaningful growth figures for those taxes since 2004. Relative to the growth of the state economy and in absolute terms, mining tax revenues have increased hugely, and unemployment assessments also grew sharply. Miscellaneous taxes increased very slightly in nominal terms; with the economy experiencing negative growth, they grew slightly faster relative to it.

	Percent Total Change vs. Change in Personal Income		
	FY 2014 \$ Million	2008-2014	2004-2014
<b>Taxes Analysis</b>			
Sales and use taxes	1,086	-5	-10
Gaming taxes	923	-11	-21
Modified business taxes	383	22	65
Insurance premium taxes	257	-4	-6
Property and transfer taxes	210	-26	-26
Motor and special fuel taxes	270	-12	-28
Liquor and tobacco taxes	133	-18	-34
2010 Motor vehicle gov't services tax	62	NMF*	NMF
Net proceeds of minerals tax	64	70	163
ST auto-lease + transient lodging taxes	187	NMF	NMF
Unemployment assessments	537	34	38
Other taxes	242	14	6
Total Taxes	4,353	3	-2

Notes: Modified business tax first collected in 2004; low first-year revenue makes percent change figure NMF.

Motor vehicle basic government services tax depreciation schedule changed in 2010; so, no meaningful growth figures.

Transient lodging tax (75% of its category) was not collected until 2012; so, no meaningful growth figures.

\* NMF, no meaningful figure





Revenues from all other tax categories decreased. Relative to Nevada's economy, sales- and use-tax revenues shrank 10% over the last decade, while gaming-tax revenues dropped 21%; these are the two largest sources of Nevada state tax revenues. The smaller sources – insurance, property, motor fuels and liquor and tobacco taxes – shrank relative to state income growth by amounts from 6% to 34% over the decade.

However, taking all tax sources together, total tax revenues declined relative to incomes by 2% over the decade but grew by 3% relative to incomes over the last six years. Thus, tax revenues in recent years have more than kept up with the growth of Nevada's economy in recent years, proving yet again that the state has a spending problem, not a revenue problem. As pointed out in the first Controller's Monthly Report, state spending grew 10% faster than the economy, making this point even more strongly.

**2) Taxes, Being Inherently Destructive, May or May Not Be Justified by the Spending They Facilitate. So Controlling Spending Is Paramount:** Private-sector transactions are mutually beneficial to those involved because they are mutually voluntary; if a person does not benefit from a transaction, he does not participate. Hence, private transactions should be presumed to be in the public interest and unhindered unless some affirmative basis for regulation or prohibition is clear. One basis for possible restraint arises when a transaction between two parties has negative consequences, or "negative externalities", for a third party. The mere existence of negative externalities does not, however, justify prohibiting the transaction or even in many cases regulating or taxing it. This very complicated subject may be addressed in a future Controller's Monthly Report.

Transactions between people or organizations and government, however, are coercive in their nature -- or they require other transactions that are coercive to facilitate them (for example, taxes to support benefit payments). Being coercive (destructive), all public-sector actions (spending, taxing, regulation and laws) should be subject to scrutiny prior to implementation to determine whether the social benefits they are reasonably expected to deliver clearly exceed their costs (social damage). The destruction from taxation is certain, immediate and ineluctable, but the purported benefits from public spending are uncertain, delayed and contingent. In some cases public spending even has negative externalities of its own. For example, welfare programs in the 1990s fostered dependencies and dysfunctional behavior by adults that had negative consequences on children; adopting

welfare reform significantly reduced these problems and the social costs of that public spending.

The upshot is that there should be no baseline assumption that regulation, taxation or even public spending is in the public interest. Instead, rigorous scrutiny must be applied to all public-sector actions and programs to protect the public interest.

Public advocacy and debate for new and increased spending and taxing measures regularly overlooks this point and often gets matters completely backwards. Thus, spending and tax advocates typically ignore or simply deny the substantial prompt, certain and inevitable social damage done by taxing. They treat tax dollars as if they were free for the taking, and they flog at great length the claimed benefits of the spending they support, ignoring that such benefits are delayed, uncertain and contingent.

Sometimes they even claim that people and firms with high incomes and wealth levels do not deserve them and should have them taxed away, allegedly because they obtain their incomes and wealth at the expense of others. In market sectors, people and firms do not get income and wealth via such predation; instead, they get it in rough proportion to the value they deliver to others. (That is, each voluntary exchange generates a producer benefit as well as a consumer benefit. So, high-income and wealthy people are generating lots of consumer benefit or well-being for others in market sectors.) So, market-based incomes and wealth are a direct indication of the contributions people and firms make to the public interest. In government, where income is generated via political processes – including for crony capitalists who live off politics and not private-sector productivity – some people and firms get theirs via predation. True, most vendors to government earn their keep by winning competitive bid processes and delivering value, instead of via political influence. But substantial amounts are also reaped by those who use the political allocation of resources to their benefit.

Elected officials and public employees must be particularly wary of failing to give full recognition to the damage from taxes, regulation and other public action and overstating the benefits from public spending and regulation. This is especially important when advocating for their agencies or pet causes. Elected officials and public employees' primary duty is owed to the voters, taxpayers and broad public interest – not to the agencies for which they work, the clientele



those agencies serve (with some exceptions), nor to the great causes that officials and employees may believe they advance via their jobs. Rhetoric about the value of whatever services a public agency provides (including education, health care, regulation, public safety, etc.) can and often does cause politicians and public employees to fail their most fundamental duty to the voters, taxpayers and broad public interest: sober balancing of social costs of taxation, regulation and spending against the benefits from services for which taxes pay. Public agencies and noble causes can become predatory upon the broad public interest, and they regularly do so.

**3) Taxes Are Inherently Unfair; the Policy Goal Is to Maximize Economic Growth:** Taxation supports public spending (for example, on national defense) that is not caused to be incurred by particular taxpayers, but instead is incurred for the benefit of many or all. Nor is it possible practically to quantify the benefits received by each taxpayer in order to assign tax burden on that basis. Thus, taxation is inherently unfair for not being set by the costs caused nor the benefits received, and almost all claims of fairness or unfairness related to taxes are suspect. Instead of a subjective, self-serving and illusive notion of “fairness” in tax design, the guiding broad public policy goal should be maximizing economic growth because that maximizes total human wellbeing.

So-called “ability to pay” criteria are quite pernicious in this regard, because they ignore the fact that in a market economy people get income and acquire wealth generally in proportion to the value they deliver to others. True fairness requires letting people who create and produce to keep the fruits of their productive activities. That also encourages others to work, invest or save, create and produce, further benefitting the public. Hence, ability-to-pay criteria tax those who most serve the public interest as creators and producers, and they reduce incentives for productive work, saving and investment. So, “redistribution” is the epitome of unfairness in a mainly market society. And no legitimate claim of “compassion” can be made by a person advocating taking from one party to give to another; real compassion is

shown when folks give of their own resources voluntarily to others, not when government or others coerce someone to give.

Finally here, income-based taxes are among the most destructive and should be avoided if at all possible. When we tax something, we get less of it. Income is derived from doing productive work or from taking the risk of investing savings. Both of these activities are very beneficial to society. So, income-based taxes, including business margins taxes, reduce the levels of socially beneficial work and savings/investment, and thus reduce economic growth and human wellbeing.

**4) The Systematic Bias Toward Taxing and Spending Is the Real Problem:** This problem is laid out in the summary. An example of it that also illustrates how advocates get real fairness issues backwards arises when Nevada public employees complain lately that they have not had a raise in several years. Over the last six years, Nevada taxpayers have actually seen their average incomes decline by nearly 8% (from \$39,079 in 2008 to \$36,039 in 2010) before rebounding slowly back to prior levels (\$39,173 in 2014). Public employees who have neither suffered cuts nor received raises in six years (or even longer) and who continued their employment voluntarily have done better than the people paying them via taxes taken coercively by the state. Further, the accumulated and ever-increasing over-reach of government is greatly responsible for the slow economic growth of recent years and the prospects of more of the same in the future. So, voters, taxpayers and the broad public interest are the victims of government excess, while public employees are to some extent its beneficiaries.

I sympathize and agree with employees who say that going years without pay increases is unfair and wrong. I strongly want to see the restoration of growth in Nevada’s economy that will allow regular state pay increases to resume, because that growth will also raise the incomes of all Nevada families and businesses. To do that, we must rein in the excesses of government and achieve better cost management.

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